No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.,*

Respondents.

A. G. BECKER, INC.,

Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.,*

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION AND THE AMERICAN BANKERS ASSOCIATION AS AMICI CURIAE

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INTEREST OF AMICI CURIAE

The New York Clearing House Association (the "Clearing House") is an association of twelve leading commercial banks

that are located in New York City.[1] The Clearing House operates electronic payment systems and clears commercial drafts and items in the New York area. The American Bankers Association (the "ABA") is the national organization of banking, numbering within its membership some 13,600 or approximately 91 percent of the nation's commercial banks. Both associations file briefs as amici curiae in appeals that raise significant questions of banking law. The Clearing House appeared as amicus curiae before the Court of Appeals for the District of Columbia Circuit in this action.

Members of the Clearing House and the ABA have a direct and vital interest in the proper interpretation of Federal banking statutes such as the Glass-Steagall Act. These associations, together with their constituent members, believe that the decision of the Court of Appeals correctly interprets the Glass-Steagall Act and sustains the lawful exercise of commercial banking powers. The Clearing House and the ABA further believe that the views presented in this brief will significantly aid the Court in its consideration of issues arising under the Glass-Steagall Act.

INTRODUCTION

The decision below correctly held that the commercial paper obligations placed by Bankers Trust Company ("Bankers Trust") do not constitute "securities" within the meaning of §§ 16 and 21 of the Banking Act of 1933 (the "Glass-Steagall Act" or "Act"), 12 U.S.C. §§ 24, 378 (1982), and that the action of the Board of Governors of the Federal Reserve System (the "Board") in declining to initiate cease and desist proceedings with respect to Bankers Trust's commercial paper activities was therefore lawful. Supplementing the arguments

[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, National Westminster Bank and European American Bank & Trust Company.

presented by the Board and Bankers Trust concerning the inapplicability of the Glass-Steagall Act to Bankers Trust's commercial paper activities, this brief shows that the meanings assigned to the operative statutory terms by the petitioners are not the meanings assigned to them by the Glass-Steagall Congress, and that those terms, as properly understood by the Court of Appeals, do not encompass commercial paper.

The question before this Court is whether commercial paper is a "security" within the meaning of the Glass-Steagall Act. Because commercial paper consists primarily of negotiable promissory notes, petitioners would have this Court assume that commercial paper obligations are necessarily "notes" and, therefore, "securities" within the meaning of § 21 of the Act, 12 U.S.C. § 378 (1982), which forbids commercial banks to underwrite issues of "stocks, bonds, debentures, *notes,* or other securities" (emphasis added). As the Court of Appeals correctly held, however, the relevant provisions of the Glass-Steagall Act have no bearing on commercial paper. They were intended to limit the ability of commercial banks, institutions of the commercial credit markets, to undertake certain activities in the capital finance markets. Commercial paper transactions take place within the commercial credit markets, a traditional sphere of commercial bank activity, not in the capital finance markets, the traditional domain of investment bankers. As we show below, petitioners' assumption that commercial paper obligations are "notes" within the purview of the Glass-Steagall Act, and the conclusion flowing from it—that such obligations are therefore "securities"—are both fundamentally mistaken.

SUMMARY OF ARGUMENT

1. The term "note" may be used in finance to refer either to commercial paper or to a type of capital security that closely resembles a bond or debenture. The context in which the Glass-Steagall Act employs the term clearly indicates that it refers only to the latter type of "note", and that the Act does not encompass commercial paper either as a "note" or as a "security". In drafting the Act, Congress had no reason to include commercial paper as a "security", for it was concerned

only with commercial banks' dealings in instruments of capital finance, not with their dealings in commercial credit instruments such as commercial paper. Moreover, commercial paper poses none of the specific risks—either to banks themselves or to bank depositors—that the Glass-Steagall Act addresses.

2. The inclusion of some forms of commercial paper within the much broader definition of "security" contained in the Securities Act of 1933 is irrelevant in interpreting the Glass-Steagall Act because these statutes serve markedly different purposes.

ARGUMENT

I.

COMMERCIAL PAPER IS NOT A "SECURITY" WITHIN THE MEANING OF THE GLASS-STEAGALL ACT.

Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378 (1982), effectively bars commercial banks from dealing in "stocks, bonds, debentures, notes, or other securities".[2] In petitioners' view, commercial paper obligations, which are short-term, negotiable promissory notes,[3] are necessarily

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[2] Sections 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh) and 378 (1982), approach the legislative goal of separating the business of commercial banking from that of investment banking from different directions. Section 16 forbids commercial banks to underwrite "securities or stock", while § 21 forbids underwriters of "stocks, bonds, debentures, notes, or other securities" to accept deposits. As this Court has recognized, "§ 21 present[s] the converse situation of § 16", *Board of Governors v. Investment Company Institute,* 450 U.S. 46, 63 (1981), and the scope of the provisions is substantially the same, *Investment Company Institute v. Camp,* 401 U.S. 617, 635 (1971).

The inquiry in this litigation as to whether commercial paper is a statutory "security" has focused on § 21 because it is the more specific provision and is the provision on which petitioners rely.

[3] *See, e.g.,* Hurley, *The Commercial Paper Market,* 63 Fed. Res. Bull. 525, 525 (1977); Comment, *The Commercial Paper Market and the Securities Acts,* 39 U. Chi. L. Rev. 362, 363-64 (1972).

"notes" within the meaning of the Act, and are therefore statutory "securities". (SIA Br. at 12; Becker Br. at 26.) In the financial world with which the Glass-Steagall Act is concerned, however, the term "note" may be used in several distinct senses. It may refer generically to any promissory instrument.[4] It may also be used to refer more specifically either to commercial paper or to a particular instrument of capital finance, hereinafter referred to as an "investment note", that differs radically from commercial paper.[5] The context in which the term is used will determine which of these financial meanings it bears.

The language of § 21 shows on its face that Congress did not intend the term "notes" to have the broad generic meaning, encompassing any promissory instrument, that petitioners espouse. When used in this broad sense, the term encompasses bonds and debentures as well as commercial paper and longer-term "investment" notes. *See, e.g.,* E. Farnsworth & J. Honnold, *Commercial Law* 51 (3d ed. 1976); *Encyclopedic Dictionary of Business Finance* 73 (1960). Because § 21 refers in terms to "bonds" and "debentures" as well as to "notes", the statute would be redundant if the latter term were given its broad generic meaning. Accordingly, analysis of the statutory language must start from the premise that the term "notes" is not all-embracing, but necessarily refers to some *specific type* of promissory obligation.

Where, as here, a statutory term is "capable of many meanings", a reviewing court must carefully scrutinize the language of a statute that employs the term "in order to avoid the giving of unintended breadth to the Acts of Congress".

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[4] *See, e.g.,* G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 724 (8th ed. 1983) (a "note" is "[a] promise to pay as distinguished from an order to pay, such as a draft or check").

[5] Petitioner Becker describes the term "investment note" as "heretofore unknown" (Becker Br. at 26). It is true that in financial circles such obligations are typically referred to, without qualification, as "notes", as they are in the Glass-Steagall Act. Nonetheless, the term "investment note" is sometimes used. G. Munn & F. Garcia, *supra,* at 127 ("A bond differs from an investment note only in the time which it has to run before maturity").

Jarecki v. G.D. Searle & Co., 367 U.S. 303, 307 (1961). As we show below, the language, the legislative history and the basic purposes of the Glass-Steagall Act combine to demonstrate that Congress used the term "notes" in § 21 to refer to the type of note that is a capital finance instrument, not to commercial paper. This analysis also demonstrates that commercial paper cannot be a "security" within the meaning of the Act.

A. The Term "Note" Has Two Distinct Financial Meanings.

The term "note" is often used in finance to refer to a specific type of long-term debt security, herein referred to as an "investment note", that closely resembles a bond or debenture but is of shorter maturity. *See, e.g.*, 1 A. Dewing, *The Financial Policy of Corporations* 178 (5th ed. 1953); H. Lyon, *Corporations and Their Financing* 227 (1938); E. Mead, *Corporation Finance* 301 (rev. ed. 1919) (A14)[6]; N. Moore, *Dictionary of Business Finance and Investment* 292 (1975); G. Munn & F. Garcia, *supra*, at 127. The financial functions, investment characteristics, and other distinguishing features of such investment notes differ sharply from those of commercial paper.

Bonds, debentures, and investment notes serve similar financial functions. Specifically, they enable the corporation issuing them to borrow money over an extended period of time for use as part of its "permanent" capital structure. *E.g.*, H. Lyon, *supra*, at 219-24, 226-27; H. Moulton, *The Financial Organization of Society* 107, 111-18, 165 (2d ed. 1925) (A16, A17-A21, A22). The chief difference between investment notes

[6] Throughout this section of the brief, an effort has been made to cite both recent authorities and authorities roughly contemporary with, or older than, the Glass-Steagall Act, the purpose being of course to show that the usages under discussion were current when the Act was passed.

For the Court's convenience, cited portions of some of the older authorities are reproduced in Appendix A hereto. Citations to authorities so reproduced are followed by the notation "(A)", indicating the page of the Appendix at which the cited passage appears.

and bonds or debentures is one of maturity. Whereas bonds and debentures typically mature in a period of 15 or 20 years or more, investment notes typically mature a few years after issuance, *e.g.*, 1 A. Dewing, *supra,* at 178; E. Mead, *supra,* at 301 (A14); G. Munn & F. Garcia, *supra,* at 127. Investment notes are often used in lieu of bonds or debentures to secure long-term financing at a time when conditions do not favor issuance of very long-term securities, as when interest rates are high or future business conditions uncertain; they satisfy the issuer's capital needs until conditions become more favorable for a longer-term issue. *E.g.*, E. Mead, *supra,* at 301 (A14); H. Moulton, *supra,* at 113-18 (A19-A21).

Bonds, debentures, and investment notes are also closely related from the investor's point of view. An investor's decision to purchase any of these securities reflects his assessment of the rewards and risks of owning a security that will not mature until the relatively distant future. Because the capital finance markets are capable of accommodating issuers of widely varying degrees of financial strength, yields will vary considerably among issuers,[7] and some issues will be relatively speculative, compensating the holder for his greater risk with a correspondingly greater return. In addition, because such securities are often purchased at a discount from or premium over their face values, the prospect of long-term capital gains or losses will often affect the calculation of total return. Moreover, the investor may realize capital gains or losses on a bond, debenture, or investment note before maturity if he sells it in the secondary markets which exist for such securities. Finally, the purchaser of such a security assumes not only the credit risks associated with the issuer's financial strength, but also the market risks inherent in any capital investment, for changing market conditions may cause the investment to decline in value or become illiquid, regardless of the issuer's strength.

Commercial paper, while consisting of promissory "notes", is different in every relevant respect from capital finance instruments such as investment notes.

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[7] *See* Appendix B, which reproduces from *The Wall Street Journal* sample "tombstone" notices for several new issues of investment notes.

Corporations usually issue commercial paper to obtain short-term credit to finance current transactions or for current cash requirements, not to obtain capital funds for long-term projects. *E.g.*, N. Baxter, *The Commercial Paper Market* 59, 62-63, 75 (1966); R. Foulke, *The Commercial Paper Market* 4-5 (A3-A4)(1931). Some firms issue commercial paper to meet seasonal needs, while others issue such paper throughout the year in response to fairly continuous short-term needs. *E.g.*, N. Baxter, *supra,* at 32-33, 62-63; A. Greef, *The Commercial Paper House in the United States* 249-50 (1938); Hurley, *supra,* 63 Fed. Res. Bull. at 526-27. In either case, commercial paper serves as an alternative to bank loans as a source of short-term financing. *E.g.*, N. Baxter, *supra,* at 10-12, 59-66; A. Greef, *supra,* at 249; Hurley, *supra,* 63 Fed. Res. Bull. at 525. Reflecting this role of commercial paper as a means of interim financing, commercial paper maturities are very brief; in the 1930's, they averaged from four to six months, *e.g.*, A. Greef, *supra,* at 231, while now they typically range from 30 to 90 days and do not exceed 270 days, *e.g.*, N. Baxter, *supra,* at 30; Hurley, *supra,* 63 Fed. Res. Bull. at 530; *see also* Securities Act of 1933, § 3(a)(3), 15 U.S.C. § 77c(a)(3) (1982). Commercial paper is thus similar in nature to other commercial credit instruments, such as bankers' acceptances and certificates of deposit, that have never been viewed as "securities" under the Glass-Steagall Act.

For the buyer as well as the issuer, commercial paper performs functions very different from those of capital finance instruments such as investment notes. For the buyer, commercial paper is not a long-term investment, but is simply a convenient means of obtaining a return on temporarily idle funds, *e.g.*, N. Baxter, *supra,* at 23, 81-83, 91-96; A. Greef, *supra,* at 307, 324. The buyer tailors the amounts and maturities of the commercial paper it purchases to reflect its projected near-term needs for cash. *E.g.*, N. Baxter, *supra,* at 82, 100-03; A. Greef, *supra,* at 233, 324. Commercial paper is not purchased by the general public, but by institutions and, occasionally, by those few individuals who have very substantial sums available for short-term lending. *E.g.*, N. Baxter,

supra, at 29, 39-41; A. Greef, *supra*, at 292-306; Hurley, *supra*, 63 Fed. Res. Bull. at 525, 529. Because the commercial paper market is ordinarily accessible only to firms of prime financial capacity, *e.g.*, R. Foulke, *supra*, at 30-31 (A5-A6); A. Greef, *supra*, at 235; Hurley, *supra*, 63 Fed. Res. Bull. at 527-29, the rate of return on such paper primarily reflects prevailing money market rates, with risk premiums playing a relatively insignificant role, *e.g.*, A. Greef, *supra*, at 319-20, 372; Hurley, *supra*, 63 Fed. Res. Bull. at 530-31. Commercial paper is not a vehicle for capital appreciation or for any form of speculation. Its brief maturity precludes the possibility of long-term capital gains, and there are no organized secondary markets in which speculative profits might be taken, *e.g.*, N. Baxter, *supra*, at 109-18; Hurley, *supra*, 63 Fed. Res. Bull. at 529.[8] Unlike capital finance instruments, commercial paper is not subject to market risk, in that its value does not fluctuate in response to market pressures, *e.g.*, R. Foulke, *supra*, at 92 (A8), and it is subject only to slight credit risk, for it is issued only for short periods and only by strong issuers, A. Greef, *supra*, at 316. *See also* N. Baxter, *supra*, at 26; A. Greef, *supra*, at 307-08; Hurley, *supra*, 63 Fed. Res. Bull. at 532-33.

In short, investment notes and commercial paper are "notes" of very different species.[9] As we show below, the Glass-Steagall Act applies only to investment notes and has no bearing on commercial paper.

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[8] Most purchasers of commercial paper hold it to maturity, and the secondary market, to the limited extent one exists, involves occasional repurchases of paper by dealers from their customers. M. Stigum, *The Money Market* 640-41 (rev. ed. 1983).

[9] Investment notes differ from commercial paper in several respects in addition to those discussed above. For example, investment notes, like other debt securities, traditionally pay interest at a fixed rate and at stated intervals, usually semiannually. *E.g.*, 1 A. Dewing, *supra*, at 171, 180-183; G. Munn & F. Garcia, *supra*, at 126-27. Commercial paper often does not promise in terms to pay interest, its holder receiving a return only through discounting. *E.g.*, N. Baxter, *supra*, at 28; R. Foulke, *supra*, at 91 (A7). When offered to the public, investment notes must be governed by a trust indenture, a comprehensive agreement between the issuer and a trustee that specifies the respective rights, powers, and obligations of noteholder

B. The Language of the Glass-Steagall Act Demonstrates That Commercial Paper Is Neither a "Note" Nor a "Security" Within the Meaning of the Act.

Section 21 of the Glass-Steagall Act bars the business of deposit banking to underwriters of "stocks, bonds, debentures, notes, or other securities". The first three items in the list, stocks, bonds, and debentures, are instruments used to obtain long-term capital financing. Ordinarily, therefore, one would expect the next item in the list to be another instrument of long-term capital finance that is significant enough to warrant separate mention. *See, e.g., Jarecki v. G.D. Searle & Co., supra,* 367 U.S. at 307 (statutory term "gathers meaning from the words around it"). The only logical choice for this next place in the statutory list is the investment note, an instrument that, as shown above, closely resembles a bond or debenture in function and is sufficiently important in finance to require separate mention, lest the statutory prohibition be evaded.

Commercial paper could not logically fill this place in the list, for it is a form of obligation with purposes and characteristics very different from those of the other items. Unlike stocks, bonds, and debentures, commercial paper does not form any part of a corporation's permanent capital structure, it is not held for long-term return, it is not actively traded in secondary markets, and its lifespan is measured in months or days, not

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and issuer. *See* Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1982); 1 A. Dewing, *supra,* at 171-75, 176-83. Commercial paper is rarely issued pursuant to a trust indenture, but bears its contract, a simple obligation to pay, upon its face. *E.g.,* N. Baxter, *supra,* at 28; A. Greef, *supra,* at 223. Because investment notes typically represent complex agreements between issuer and holder, they are usually elaborate, formal instruments, often under seal. *E.g.,* H. Lyon, *supra,* at 227; G. Munn & F. Garcia, *supra,* at 126-27. Commercial paper instruments are generally very simple in form. *E.g.,* N. Baxter, *supra,* at 28; A. Greef, *supra,* at 222-29. *See also* R. Foulke, *supra,* at 150-52 (A10-12). Finally, because commercial paper is an essentially simple instrument, issued only in large denominations to a comparatively small number of purchasers, it entails transaction costs significantly smaller than those of an underwriting of securities.

years or decades.[10] Moreover, given the context supplied by § 21, which naturally suggests capital finance instruments, it is difficult to suppose that Congress intended to use the term "notes" in a peculiar dual sense encompassing both commercial paper and investment notes. The term is not ordinarily used in such a double sense, and it would stretch credulity to suppose that Congress, in drafting a statute specifically addressed to the financial community, would have assigned to a familiar financial term a distinctive meaning that is actually concealed by the context.[11]

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[10] Petitioners make much of the fact that instruments denominated bonds and debentures sometimes have brief maturities. *See* Becker Br. at 38 n.65 and Supp. App.; SIA Br. at 16. While such anomalies do exist, the fact remains that the vast majority of bonds and debentures are long-term instruments that mature 15 or 20 years or more after issuance. *See* pp. 7-8, *supra.* Indeed, several of the specific issues of securities cited in Becker's Supplemental Appendix are denominated "certificates of indebtedness", not "bonds" or "debentures" (Becker Br. S2, S3, S7). Most of the others are serial issues, in which portions of the issue are redeemed at different times, sometimes commencing shortly after issuance, but the issue as a whole is not retired for a number of years (*id.* S4, S6, S9, S10, S12, S13, S15).

In similar manner, petitioners attempt to confuse the issue by pointing to the fact that some commercial paper issuers "roll over" their outstanding obligations on a regular basis, thus employing short-term funds for longer-term purposes. (Becker Br. at 27 n.40; SIA Br. at 16.) Whether or not the issuer seeks to "roll over" the debt, commercial paper remains short-term in character. The purchaser is entitled to redeem the paper according to its tenor at maturity, and the issuer must either pay or refinance its obligations as they fall due.

[11] *See* 2 F. Horack, *Sutherland's Statutes and Statutory Construction* § 4919, at 441-42 (3d ed. 1943) ("Statutes dealing with trade and commerce are intended for practical use and application by men engaged in trade and commerce. . . . [I]n the absence of a legislative intent to the contrary, commercial terms when used in a statute relating to trade or commerce are presumed to have been used in their trade or commercial meaning") (footnotes omitted). *See also Corning Glass Works v. Brennan,* 417 U.S. 188, 201 (1974) ("where Congress has used technical words or terms of art, 'it [is] proper to explain them by reference to the art or science to which they [are] appropriate' ") (quoting *Greenleaf v. Goodrich,* 101 U.S. 278, 284 (1880)); *id.* at 202 (courts should accept definitions employed "across a wide range of American industry"); *NLRB v. Coca-Cola Bottling Co.,* 350 U.S. 264, 269 (1956) ("if the word be deemed to have a peculiar connotation for those intimate with [the field to which it pertains], it is incumbent upon [the court] to give the word its technical meaning").

Analysis of the statutory language also refutes the proposition that commercial paper is somehow a "security" within the Act even if it is not a "note". Ordinarily, "where general words follow an enumeration of specific items [in a statute], the general words are read as applying only to other items akin to those specifically enumerated". *Harrison v. PPG Industries, Inc.*, 446 U.S. 578, 588 (1980). Thus, the concluding phrase of § 21—"or other securities"—would ordinarily refer to financial instruments "akin" to those specifically mentioned. Because commercial paper differs radically in character and function from the instruments of capital finance specifically mentioned in the Act, it cannot reasonably be read into the Act as a "security".[12]

An examination of the purposes of the Glass-Steagall Act, as reflected in its legislative history, confirms the straightforward reading of its language presented above.

C. Excluding Commercial Paper from Coverage as a "Security" Under the Glass-Steagall Act Is Consistent with the Purposes of the Act.

Congress's concerns in drafting the Glass-Steagall Act were twofold. First, the legislators believed that extensive commercial bank participation in the capital finance markets created certain risks which adversely affected the commercial banking industry and, ultimately, the national economy. *See* pp. 13-15, *infra*. Second, they believed that the promotional pressures of investment banking could sometimes lead commercial bankers to depart from sound banking practices, thus jeopardizing bank deposits. *See* pp. 16-18, *infra*. As we show below, excluding commercial paper from coverage under the

[12] Pointing to the other references to "notes" in the federal banking laws in which Congress employed a qualifying adjective to describe the particular type of note intended, petitioner Becker asserts that the absence of such explicit qualification in § 21 of the Glass-Steagall Act indicates a congressional intent to use the term in a sense broad enough to encompass commercial paper. *See* Becker Br. at 27-28. In § 21, however, such explicit qualification was unnecessary, for it is apparent from the context that only notes having an investment character like that of stocks, bonds and debentures were intended.

Act as a "security" fully comports with the economic objectives of the statute. As we also show, commercial paper does not threaten the safety of bank deposits.

1. *The Economic Objectives of the Act.* One fundamental objective of the Glass-Steagall Act was to strengthen the operation of commercial banks in the commercial credit markets, one of their traditional domains, by limiting their exposure to risks associated with the capital finance markets, the traditional domain of investment bankers. *See, e.g., Board of Governors of the Federal Reserve System v. Investment Company Institute,* 450 U.S. 46, 61-62 (1981); *Investment Company Institute v. Camp,* 401 U.S. 617, 629 (1971); Perkins, *The Divorce of Commercial and Investment Banking: A History,* 88 Banking L.J. 483 (1971). Specifically, Congress limited the power of banks to underwrite certain capital finance instruments, to purchase them for their own accounts, and to loan money for the purpose of purchasing them. *See* Banking Act of 1933, §§ 3(a), 5(c), 9, 11(a), 16, 19(e), 20, 21, 32 (codified at scattered sections of 12 U.S.C.). Congress believed that the propensity to have bank assets "tied up" in extensive holdings of such instruments rendered banks illiquid and unduly subjected them to the market risks inherent in such investments. *See, e.g.,* S. Rep. No. 77, 73d Cong., 1st Sess., 6-7, 8-10 (1933); 76 Cong. Rec. 1405 (1933) (remarks of Sen. Glass). Congress also believed that widespread commercial bank involvement in purchases of such instruments fueled excessive speculation, thus disrupting those markets and harming all participants in them. *See, e.g.,* S. Rep. No. 77, *supra,* at 3-4, 5-7, 8-10; 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott); 75 Cong. Rec. 9911-12 (1932) (remarks of Sen. Bulkley). The Act therefore sought to curb the powers that had permitted commercial banks to invest in the capital finance markets resources which Congress thought were better committed to other areas, particularly the commercial credit markets. *See generally Board of Governors v. Investment Company Institute, supra,* 450 U.S. at 61-62; Perkins, *supra,* 88 Banking L.J. at 497-505; U.S. Dep't of the Treasury, *Public Policy Aspects of Bank Securities Activities* app. 12-15, 17-18 (1975) (hereinafter cited as "*Public Policy*"). *See also* 75 Cong. Rec. 9909 (1932) (remarks of Sen.

Bulkley) (Act limits commercial bank operations "in the long-term capital market").[13]

The only reading of the disputed phrase "notes, or other securities" that is consistent with this economic objective is one which includes within the statutory prohibition such capital finance instruments as investment notes and excludes such instruments as commercial paper. First and most fundamentally, commercial paper is a commercial credit instrument that has nothing to do with capital finance. A commercial paper transaction takes place not in the capital finance markets, *i.e.*, the securities markets, but squarely within the commercial credit markets, *i.e.*, the money markets, in which the Glass-Steagall Act sought to strengthen commercial bank operations. Thus, when participating in a commercial paper transaction, a commercial bank does not divert its resources from this traditional sphere of bank activity, but in fact retains them there.[14]

Second, and precisely because commercial paper is associated with commercial credit rather than capital finance, commercial paper transactions create none of the specific economic risks at which the Act takes aim. Commercial paper does not entail extended exposure of bank assets to market fluctuations,

[13] The Act does not wholly bar commercial banks from participating in capital market transactions. For example, they may buy and sell "securities" for their customers' accounts, may buy and sell certain "investment securities" for their own accounts, and may underwrite and deal in a wide variety of government securities. *See* 12 U.S.C. § 24 (Seventh) (1982). The principal problem, in the view of the Glass-Steagall Congress, was the degree of commercial bank involvement in relatively speculative issues, which placed bank assets at risk. *See, e.g.*, S. Rep. No. 77, *supra*, at 3-4, 6-7, 8-10. *See also* Banking Act of 1933, ch. 89, preamble, 48 Stat. 162 (statute intended "to prevent the undue diversion of funds into speculative operations").

[14] In fact, commentators have noted that investment banks that participate in commercial paper transactions are performing the traditional lending functions of commercial banks, rather than their own traditional function of facilitating long-term capital financing. *See* R. Foulke, *supra*, at 134 (A9); A. Greef, *supra*, at 379.

it does not "tie up" those assets for extended periods of time, and it is not a vehicle for speculation. As to the credit risks of commercial paper, commercial banks have traditionally assumed them not only by purchasing such paper, but also by maintaining lines of credit upon which commercial paper issuers may draw in order to redeem their paper at maturity if financial reverses or other circumstances prevent them from doing so with other funds. *See, e.g.*, N. Baxter, *supra*, at 55, 66-69. Although purchasing commercial paper or backing it with a line of credit necessarily subjects the lender to the credit risks of commercial paper, no one has suggested that such activity contravenes the Glass-Steagall Act. This is so because the risks associated with commercial paper are slight and are in any event commercial credit risks of the sort that commercial banks traditionally take, and against which banks protect themselves through credit analysis and diversification.[15]

In sum, commercial bank involvement with commercial paper is fully consistent with the economic objectives of the Glass-Steagall Act. For this reason alone, commercial paper should be excluded from coverage under the Act as a "security". Moreover, as we show below, the Act's concern for depositor protection does not justify an interpretation of its language more sweeping than that dictated by its economic goals.

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[15] Of course, losses can occur, and on a very few occasions have occurred, in commercial paper transactions. *See, e.g.*, Hurley, *supra*, 63 Fed. Res. Bull. at 532-33 and 536 n.12 (3 defaults in period 1946-1970). Nonetheless, the petitioners' concern for the economic well-being of the commercial banking industry is misdirected. Every banking activity entails some risk of loss. But in fact, the degree of risk associated with commercial paper is significantly less than that associated with traditional lending activities. *E.g.*, A. Greef, *supra*, at 307-08, 311-14.

2. *Depositor Protection.* In addition to the economic goals discussed above, the Glass-Steagall Act sought to protect commercial bank depositors from certain abuses that Congress associated with commercial bankers' activities in the securities markets. Specifically, Congress believed that a commercial bank might imprudently recommend securities owned or underwritten by it to its depositors. In addition, Congress feared that commercial banks might imprudently loan money to depositors to facilitate the purchase of such securities or to issuers of such securities who become financially embarrassed. The possibility of such imprudent sales and lending activities was thought to jeopardize the safety of bank deposits. Accordingly, a second purpose of the Glass-Steagall Act's prohibition against the underwriting of "securities" by commercial banks was to relieve commercial bankers from the promotional pressures associated with investment banking. *See generally Investment Company Institute v. Camp, supra,* 401 U.S. at 629-34 (reviewing legislative history); *Public Policy, supra,* app. at 18-21.

The commercial paper activities at issue in this litigation do not pose a credible threat to the safety of bank deposits. Unlike capital investment vehicles, commercial paper does not expose the holder to market risk, and it is rarely purchased by individuals. A bank engaged in commercial paper placements would therefore have little opportunity to foist worthless paper upon unsuspecting depositors, even in the unlikely event that it were inclined to do so. Moreover, the possibility that a placing bank might imprudently loan money for commercial paper purchases is virtually nil: almost by definition, commercial paper is purchased with the buyer's free cash reserves, not with borrowed money, and in any event the rate of return on commercial paper is usually lower than the interest rate charged on bank loans, *see, e.g.,* N. Baxter, *supra,* at 74 and n.9; A. Greef, *supra,* at 320, so that such transactions would be uneconomical and therefore exceedingly rare. In addition, because commercial paper issuers generally have prime financial capacity and arrange standby credit facilities for redeeming their paper before they issue it, the likelihood that a placing bank might be tempted to "bail out" an embarrassed issuer

with imprudent loans is minimal.[16] Thus, the Act's concern with depositor protection has little or no relevance to commercial paper.

Furthermore, to the extent that these concerns might conceivably bear upon commercial paper, the Board has dealt with them in its guidelines, *see* Board of Governors of the Federal Reserve System, *Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks,* 46 Fed. Reg. 29,333 (1981) (hereinafter cited as "*Policy Statement*"). These guidelines merely reiterate and reinforce the realities of the commercial paper market that make commercial paper an extremely unlikely vehicle for depositor abuse. They eliminate the already slight possibility that worthless paper might be "unloaded" upon the unwary by limiting placements to paper of "prime" quality and by forbidding placement of paper with the placing bank's trust accounts, with its nonbank affiliates, or, in general, with any financially unsophisticated buyer.[17] *Id.* at 29,334-35. In addition, the guidelines correctly recognize that the interest rate differential between direct bank loans and commercial paper precludes the possibility of imprudent lending to finance paper purchases. *Id.* at 29,334. The limitation of placements to prime quality paper minimizes the possibility of unsound lending to financially troubled issuers. Moreover, the guidelines further diminish this possibility by

[16] Extensive regulation of commercial bank lending policies for their safety and soundness, *see, e.g.,* 12 U.S.C. § 1818(b) (1982), further diminishes this already slight possibility of unsound loans to issuers.

[17] Moreover, under the guidelines banks may not advertise paper to the general public and may not place it in denominations of less than $100,000. *Policy Statement, supra,* 46 Fed. Reg. at 29,334. These restrictions further ensure that paper will be placed only with buyers who are capable of appraising the issuer's creditworthiness independently. Significantly, these restrictions merely reflect standard practices that have prevailed in the commercial paper market for many years. Historically, dealers have not offered paper to the general public, *see, e.g.,* A. Greef, *supra,* at 326-28, and the large minimum denomination of dealer paper has precluded purchases by most individuals, *see, e.g.,* Hurley, *supra,* 63 Fed. Res. Bull. at 528.

requiring careful review of an issuer's financial condition, and by requiring senior management of the placing bank to establish internal limits for paper placements that reflect both the issuer's financial condition and the placing bank's commitments, if any, to extend credit to the issuer. *Id.*

This Court has recognized, in a related context, that such an effective scheme of regulation can indeed alleviate concerns which might otherwise require an expansive classification of a particular financial instrument as a "security" for statutory purposes. *See Marine Bank v. Weaver*, 455 U.S. 551, 558 (1982). Because the Board's guidelines adequately address the Glass-Steagall Act's concern for depositor protection, they would effectively remove that concern from this case even if it were relevant to commercial paper—which it is not.[18] Accordingly, principles of depositor protection cannot justify including commercial paper—an instrument wholly irrelevant to the economic objectives of the Act—within the Glass-Steagall Act as a "security".

II.

THE DEFINITION OF "SECURITY" CONTAINED IN THE SECURITIES ACT OF 1933 REFLECTS THE BROAD PURPOSES OF THAT ACT AND IS IRRELEVANT IN DETERMINING WHETHER COMMERCIAL PAPER IS A "SECURITY" WITHIN THE MEANING OF THE GLASS-STEAGALL ACT.

Section 2(1) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77b(1) (1982), like the definitional provisions of other later-enacted securities laws, defines the term

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[18] The Board's decision to promulgate the guidelines does not indicate that commercial paper poses a sufficient risk to bank deposits to warrant its classification as a "security". The guidelines themselves merely ensure that banks' authority to place commercial paper will not be transmuted by gradual changes in practice. The Board viewed such a risk as remote. *See Policy Statement, supra*, 46 Fed. Reg. at 29,333 ("certain practices *may* develop . . . that *may* not be consistent with" sound banking principles) (emphasis added). Moreover, because the guidelines for the most part reiterate standard industry practice, they are actually predicated upon the fact that commercial bank involvement in commercial paper transactions poses little risk for depositors.

"security" broadly enough to include some forms of commercial paper. *See also id.* §§ 77c(a)(3), 77*l*(2). Petitioners assert that commercial paper is therefore also a "security" within the meaning of the Glass-Steagall Act, which was enacted at about the same time as the 1933 Act. (Becker Br. at 30; SIA Br. at 17-18.) Comparison of the very different purposes of these bodies of legislation demonstrates that this conceptual leap is not justified.

One overriding purpose of the 1933 Act and of other federal securities laws was to protect the public from abuses of fraud and deception that may occur whenever members of the public invest their money in hope of sharing profit opportunities with entrepreneurs. *E.g., SEC v. W.J. Howey Co.,* 328 U.S. 293 (1946). To achieve this purpose, Congress defined the term "security" in the 1933 Act with remarkable breadth.[19] The definition applies to a very wide variety of interests in arrangements for common gain, whether the arrangements are speculative or nonspeculative in character, whether the interests involved are valueless apart from the arrangement or have intrinsic value, and regardless of the legal characterizations that might otherwise apply to either the interests or the arrangements concerning them. *E.g., id.* at 300-01. The 1933 Act has been held to encompass not only such traditional investment media as stocks and bonds, but also such comparatively exotic

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[19] As originally enacted, the 1933 Act defined the term "security" as follows:

> "The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of interest in property, tangible or intangible, or, in general, any instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing." Securities Act of 1933, ch. 38, tit. I, § 2(1), 48 Stat. 74 (current version at 15 U.S.C. § 77b(1) (1982)).

The definition was amended, and further broadened, by the Securities Exchange Act of 1934, ch. 404, tit. II, § 201(a)(1), 48 Stat. 905.

"securities" as an agreement concerning the breeding of chinchillas, *Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414 (8th Cir. 1974), and a common pyramid scheme, *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974). Such broad scope is in keeping with the broad statutory purpose of protecting investors from "the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits". *SEC v. W.J. Howey Co., supra,* 328 U.S. at 299.

Reading the broad 1933 Act definition of "security" into the Glass-Steagall Act would stretch the latter Act far beyond its intended bounds. Unlike the 1933 Act, the Glass-Steagall Act does not purport to protect investors who may be enticed by "countless and variable" profit-making schemes; it has the much more specific purpose of protecting bank depositors by limiting the power of commercial banks to place deposits at risk in the capital finance markets. *See* pp. 13-18, *supra.* The language of the Glass-Steagall Act reflects this more specific purpose. While broad enough to achieve its intended purposes, *see Investment Company Institute v. Camp, supra,* 401 U.S at 635, that language refers in terms only to traditional instruments of capital finance, and, unlike the language of the 1933 Act, it does not purport to be all-embracing. The Glass-Steagall Act is not concerned with instruments such as commercial paper that are classically disassociated from capital finance. The status of commercial paper under the 1933 Act and other securities laws is therefore irrelevant in determining whether such paper is a "security" within the meaning of the Glass-Steagall Act.

CONCLUSION

For the reasons stated above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX A

THE COMMERCIAL PAPER MARKET

By

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and industrial lines of business, which offer notes through commercial paper brokers, to turn over their merchandise and thus make their notes self-liquidating.

In the broader economic sense and in its legal interpretation, the term "commercial paper" covers a much wider field, including all classes of short term negotiable instruments. Judge Withey in Re Nichodemus rendered the decision that the term denotes "bills of exchange, promissory notes, and negotiable bank checks,"[2] while Judge Blodgett in Re Sykes writes that the phrase "commercial paper" means "negotiable paper, that is, promissory notes or bills of exchange made by a banker, merchant or trader in the due course of his business."[3]

In the early days of the Federal Reserve System, the late Ralph Van Vechten, well known for his constructive vision in bank credit work, defined commercial paper as follows:

> Commercial paper consists of promissory notes, bills of exchange or acceptances in negotiable form representing advances to be used in the production, manufacture, distribution, or storage of commodities for which there is a constant, periodic or seasonal demand by the con-

[2] Decision rendered in U. S. District Court, E. D. Michigan, 1869. Re Nichodemus (U. S.) 18 Fed. Cas. 222-224.

[3] Decision rendered in U. S. District Court, N. D. Illinois, March 1870. Re Sykes, 23 Fed. Cas. 582-584.

sumers, merchants or manufacturers so that in the natural course of events the satisfying of this demand with a reasonable lapse of time from date of issuance of the paper will result in the payment of the notes, bills of exchange or acceptances thus created. For illustration, under this definition the financing of bricks in the process of manufacture would be proper, but the financing of a building in which these bricks are used in construction would not.[4]

While the interpretation we have given to the term "commercial paper" is restricted to the very definite field of short term credit obligations generally sold to banking institutions which do not have the deposit accounts of the concerns seeking credit, the meaning is a clear one and an accepted one in present-day American banking practice.

As the use and advantage of the open market have become more widely known, mercantile concerns in the South and the West have obtained credit from banks and trust companies a thousand or two thousand miles away in the North and the East and commercial paper has come to take on this more definite, restricted meaning. Commercial paper to a banker today has reference not to his loans and discounts, but to his investments in short term notes generally purchased from commercial paper brokers.

[4] Quoted by O. H. Wolfe, in *Practical Banking*, published by the LaSalle Extension University, Chicago, 1918. p. 99.

conditions, when the open market rate is as low or even lower than the discount rate of its own banks, it may sell its paper to the extent of its entire credit requirements. In this situation, it pays off its banks entirely, but still continues to maintain its usual bank balances. The cost of keeping such large bank balances, whether borrowing from its own banks or not, is considered in the nature of an insurance premium. It gives the company a call at all times on $25,000,000 of bank accommodation. No money stringency can ever jeopardize the position of this company so long as its fundamental financial position remains sound.[1]

This example is based on actual figures. In practice, the principle admits of much variation. It may be modified according to the size of the borrower—whether the concern has combined capital and surplus of $325,000 or $325,000,000—according to the nature and location of the business, and according to the nature of its credit needs.

The Open Market as a Credit Guide

The credit standing of a concern which sells its notes in the open market is thoroughly investigated and analyzed by six separate, distinct organizations: (1) the note broker who handles the notes, (2) banks which have the account, (3) banking

[1] Address delivered by Walter E. Sachs on "Commercial Paper and Its Place in Our Banking System," August 24, 1921, before the Kentucky Bankers Association.

institutions buying the notes under option, (4) city correspondents of the buying banks, (5) trade creditors and (6) specialized credit organizations.

Any slight question as to the inherent financial soundness of an enterprise offering its notes in the open market immediately comes to light, and the notes fail to sell. It is due to this constant routine of credit investigation and analysis, which is applied so rigorously day after day to every piece of commercial paper sold, that relatively few concerns are able, year in and year out, to keep their financial affairs in such shape that their notes will sell readily at the current market rate of discount.

The result is that any concern which is able to sell its notes in the open market may be considered in that thin, uppermost stratum representing the better risks in our industrial and commercial world. This standing is not due to the qualifying features of general business conditions in the industry, broad market movement, or the rate for money. It is based solely on the financial condition of the concern itself. It is not relative. It is absolute.

Let us see what this thin, uppermost stratum represents.

Industrial Division of Open Market Names

The early open market borrowers in the Nineteenth Century were the New York dry goods commission merchants, concerns which handled the out-

The Face Value of Commercial Paper

The institution of bonds is one of the more fundamental of our modern business institutions, one of the keystones in the archway of our business civilization. Bonds furnish the means for large savings; provide the constant funds by which savings banks pay interest; colleges, universities and endowed museums their annual expenses; and insurance companies their dividends.

Within certain limits, high-grade bonds furnish a sound investment for the surplus funds of commercial banks. The policy of investing in bonds, however, is generally limited by progressive commercial banks to such funds as can be invested permanently, funds which the bank probably will not be called upon to loan to depositors at the peak of the next borrowing season. Surplus funds which are surplus only for from three to six months, which a bank might be called upon to loan to depositors, are generally invested in open market commercial paper, as:

(1) The return is fixed, definite, and assured.

(2) The return is in the form of a discount and not interest.

(3) Commercial paper is rediscountable at each of the twelve Federal Reserve banks.

(4) There is no charge for buying or collecting at maturity.

(5) The face value of an open market note does not fluctuate.

The face value of a commercial paper note does not fluctuate with general business conditions, the current rate for short term money, or speculative activity on the stock market. Its value, like the monetary value of gold, is fixed, definite, stable. The liquidating value of a bond, on the other hand, fluctuates from day to day and the loss of one point on the principal of a 5 per cent. bond brings the net yield for a year (after deducting the commission for buying and selling) below 4 per cent., and the loss of two points brings it below 3 per cent.

Comparison of the Net Return on Commercial Paper and Wall Street Loans

Under date of February 25, 1926, the members of the New York Clearing House Association passed an amendment to section three, article eleven, of its constitution providing for a charge of not less than 5 per cent. on the interest received upon all collateral loans placed in behalf of correspondents. This amendment became effective March 1, 1926. As a result of instituting this charge, the net return on collateral loans, both time and call loans, placed on Wall Street by out-of-town banking institutions was decreased between one-fifth and one-fourth of 1 per cent.

The return on collateral loans, moreover, is in

(1) in cash upon turning over the notes to the broker, (2) by installments as the broker is able to dispose of the paper, and (3) by a combination of the above two methods whereby the broker makes an initial advance, generally from 80 to 90 per cent. of the face amount of the paper, and remits the balance when the paper is sold.

In the first case the paper is purchased outright at a flat rate, less the broker's charge for handling or "commission," as it is termed, and the borrower receives payment as soon as the notes are delivered. In this case the broker fills a very definite niche in the economic life of our country, acting largely as a retail dealer, his stock-in-trade consisting of commercial paper instead of dry goods, groceries, shoes or hardware. If the rate on the open market should advance before the block of paper is disposed of, the margin of profit decreases and might even disappear; if, on the other hand, the rate should decline, a profit is realized in addition to the regular commission. It is, of course, only the larger brokerage houses with strong financial resources and banking credit which are able to purchase all of their paper outright in this manner.

Theoretically, such operators are more bankers than brokers for they extend short term credit, even though that credit is to be transferred as soon as possible to some other source. Probably the greater volume of paper now placed on the open

condition of his borrower; and (2) he is ready to take paper at a moment's notice for immediate distribution. When open market rates soften a trifle, that is, show a tendency to go lower, the brokers are particularly active in advising their clients of the condition of the money market and the rate at which paper can be sold. At such times they telephone local clients, write letters to out-of-town clients to obtain additional paper, and also address letters to prospective clients. The following is a typical letter sent out by well-known commercial paper brokerage houses at such times:

Gentlemen:

Can you use any four, five or six months' funds to advantage at the present rate? If so, we should be glad to have you advise us. Rates are on a 4½ and 4¾ per cent. basis. Dependent somewhat on the strength of your financial statement, we could place your paper at these rates plus our commission of one-quarter of 1 per cent.

For thirty years we have specialized in commercial paper banking. We supply funds to borrowers located in all sections of the country, many of these concerns having used our facilities over twenty years.

If you are a borrower, we believe that our facilities and our organization can be of service to you. We make outright purchases of our customers' notes at the existing market rate.

Yours very truly,

The Proper Form in Making Open Market Notes

According to current banking practice, eight important points should be kept in mind when notes

are being drawn by a concern to be offered on the open market:

(1.) The denomination of the note, whether $2500, $5000, $10,000 or $25,000, should be specified in the upper left hand corner of the note.

(2.) The location of the borrower, the state and city, followed by the date of the note, should be specified in the upper right hand corner. Notes should never be dated ahead. Occasionally notes are sent to a broker before the time when the funds are desired. In these cases it is better to have the date blank and give the broker the privilege of dating the paper. In these cases the discount is charged, not from the time notes are received, but from the date funds are placed at the disposal of the borrower.

(3.) A specified maturity date such as "August 31, 1928," and not "so many months after date" should be inserted. This practice does away with any possibility of mistakes in the maturity by incorrect calculations from the date; it insures the desired date for payment.

(4.) Notes should be made payable to "ourselves" (maker) and should be endorsed on the back in exactly the same manner as signed on the face of the note. In the case of a corporation, the signature on both the face and the back should bear the full name of the company, signed by an official having authority to do so, that is

The John Doe Company, Inc.
By John A. Doe, President.
By Frank B. Doe, Treasurer.

If the paper also bears a personal endorsement or endorsements, they should appear below the corporation signature on the back of the note. In the case of a partnership, it is necessary for a member of the firm to sign the firm name only on the face and the back, that is, John Doe and Company.

(5.) The amount should be written out fully on the face of the note and not abbreviated.

(6.) If a depository bank is maintained in either New York, Chicago, Boston, Philadelphia or San Francisco, notes should be made payable at this institution. If a concern maintains accounts with banking institutions in several of these cities, the notes are generally made payable at the nearest bank. By far the greater percentage of all paper is made payable at a bank in New York City as New York City is the money center of the country. If no depository account is maintained at a bank in one of these cities, the New York correspondent of a local bank is generally designated.

Early in the Twentieth Century many concerns had their notes made payable at their own office and many at the offices of their brokers. These practices have now entirely disappeared.

(7.) No note should bear an erasure or any alteration. If an error is made in drawing it, a new note should be made out in correct form.

(8.) Notes should be consecutively numbered to assist in identification.

Usually Runs for from Two to Nine Months and Is Self-Liquidating

Commercial paper runs for different lengths of time but by far the greater part placed on the open market has a maturity of six months. Some brokers handle paper with maturities of two months and some even up to twelve months, but only a few concerns borrow on the open market with paper maturing in less than six months and few banking institutions will buy commercial paper with longer

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CORPORATION FINANCE

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Bank loans are not available as a source of permanent capital, although they may furnish a portion of the capital which a corporation requires. In some cases, however, a special form of obligation, either secured or unsecured, is favored by corporations, and largely sold to banks as well as to investors. This is known as the short term note. Such obligations run for one, two, or three years, and pay a high rate of interest—five or six per cent. This form of obligation is usually resorted to during periods of stringency in the money market, when long term bonds cannot be sold except on the basis of a high interest yield.

A first-class railroad corporation expects, under normal conditions of demand, to sell its first mortgage four per cent bonds at par. The money market may, however, get into such a condition that a four per cent bond of this class cannot be sold except at a price to yield five per cent to the investor. Suppose the corporation wishes to issue a thirty year bond. If it makes the issue at such a time, it will have to pay the one per cent extra for thirty years, or thirty per cent on the entire amount of the issue. Looking at the proposition solely from the standpoint of income, and assuming that an improvement in the bond market will, within two or three years, make it possible to again sell four per cent bonds at par, it is advantageous for a company, in the circumstances described, to borrow the amount required for, say, three years, paying six or seven per cent interest, and trusting to its ability to refund the obligation at maturity on a four per cent basis. Instead of paying thirty per cent premium, therefore, the company which makes an issue of two year six per cent notes, and refunds these on a four per cent basis, will only pay four per cent premium for the money over the entire period.

The conditions under which the issue of short term notes is advantageous are illustrated by the situation of the American money market in 1906. During this year, the bond market had been extremely dull. Prices generally declined; issues yielding less than four and a half per cent gained

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THE FINANCIAL ORGANIZATION OF SOCIETY

BY

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SECOND EDITION

[1925]

THE UNIVERSITY OF CHICAGO PRESS
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CHAPTER VIII

CREDIT INSTRUMENTS

The borrowing or credit operations of modern society are evidenced by written documents, drawn up in legal form, and known as credit instruments. As has already been noted, the term "credit" is often loosely employed in such a way as to give the impression that credit is a form of currency. It is not credit, however, that is used as a form of currency; it is rather the instruments which are the written evidences of antecedent credit operations that serve as media of exchange. In the present chapter we shall consider the various types of credit instruments which are employed in modern credit operations and discuss the development of certain legal principles which have made possible the effective use of these instruments in transferring the ownership of wealth.

As is indicated in the diagrams on pages 163 and 165, the capital of modern businesses is usually divided into two classes fixed and working. The financial instruments that are used in evidencing the loans made in the raising of fixed capital are usually called "investment credit instruments"; while those evidencing borrowed working capital are known as "commercial credit instruments." We shall consider the various types of instruments that fall within each class.

I. INVESTMENT CREDIT INSTRUMENTS

The three principal types of investment credit instruments are bonds, stock certificates, or shares, and short-term notes. An explanation is perhaps necessary for designating a share of stock as a credit instrument; for from a certain point of view a shareholder is legally not a creditor of the corporation but a joint owner in the enterprise. He receives income from his

so likely to mislead the innocent investor, who somehow will persist in believing that a stock whose par value is $100 will ultimately be worth $100, even though its temporary market price may be below that figure; hence he may pay for it more than its real worth. From the viewpoint of the corporation the issue of stock without par value is also a means whereby opposition to overcapitalization may in a measure be circumvented.

Stockholders' "rights" are an interesting but little-known form of credit instrument.—Stockholders' "rights" have arisen out of the exigencies of corporate financing. For instance, when the existing stock of a corporation is selling at, say, 105, additional capital can easily be raised by offering for sale new shares at par, or slightly above. But if additional shares are to be offered for sale at a bargain, it is only equitable that the existing stockholders should be given the first chance to subscribe for the new issue, because the increased capitalization may well affect the value of outstanding shares. Accordingly, it is the usual practice to allow existing shareholders to subscribe for the new issue in proportion to the amount of their holdings; indeed, in many jurisdictions the stockholders have a legal right to subscribe for new stock at par.

Such stockholders' privileges are known as "rights," and they are issued to shareholders in the form of transferable instruments. Upon the receipt of one of these instruments, the shareholder may either avail himself of the opportunity to purchase stock at par, or whatever the figure mentioned, or he may sell his right to another. These rights are in fact bought and sold on the stock exchanges in the same manner as bonds and shares. The market value of a shareholder's right is roughly equal to the estimated difference between the issue price of the new stock of the corporation and its prospective market price.

There are numerous types of bonds.—The terminology employed in describing the many different types of bonds that are in use nowadays is quite baffling to the layman. For in-

stance, a certain bond is described as follows: a 5 per cent railroad collateral trust, refunding, registered, coupon, gold bond. The whole matter may be greatly simplified by classifying bonds from certain points of view as follows: (1) the nature of the issuing corporation; (2) the purpose of the issue; (3) the conditions governing the payment of interest or principal; and (4) the character of the security.

The most important subclasses[1] under each of these headings are as follows:

1. The nature of the issuing corporation

a) Government bonds—national, state, territorial, county, city, township, school district, etc.

b) Corporation bonds—transportation, public utility, industrial, reclamation, real estate, timber, etc.

2. The purpose of the issue

a) Construction bonds

b) Improvement bonds

c) Refunding bonds

d) Equipment bonds

3. The conditions governing the payment of interest or principal. (Classification here is dependent upon the legal provisions governing payment of principal and interest.)

a) Participating bonds

b) Profit-sharing bonds

c) Registered coupon bonds

d) Gold bonds

e) Premium bonds

f) Serial bonds

g) Callable bonds

h) Convertible bonds

[1] Only the main subdivisions in each case are given. For a full classification the reader is referred to Lawrence Chamberlain, *The Principles of Bond Investment* (Henry Holt & Co.), chaps. viii to xi, inclusive. The kind of individual securities that might be listed under the various subclasses are legion.

4. The character of the security
 a) First mortgage
 b) Second mortgage
 c) Collateral trust
 d) Debenture

In the case of a first-mortgage bond the bondholders have a prior claim against income, and against property in case interest on the bonds is not paid. The mortgage pledges the property owned by the corporation as a security for the payment of interest and principal. Since it is obviously impossible to give each bondholder a share of the mortgage, the mortgage is placed in trust, and in the event of failure to pay interest the bondholders as a group may foreclose under the terms of the agreement and take possession of the property.

As the name indicates, a second mortgage constitutes a secondary claim against income and property. Anything left after payments have been made to the owners of the first mortgage may be devoted to meeting the claims of the second-mortgage holders.

A collateral trust bond is one which is secured, not by real estate or other physical property owned by the corporation, but by stock or bonds of other companies owned by the issuing corporation. This type of security is mainly found in connection with railroad companies. The term "trust" indicates that these collateral securities are placed in trust with a trust company or other trustee. In the event that interest is not paid on such bonds, the holder may seize the collateral which is held in trust.

A debenture bond proper has no mortgage security but merely a claim against the income of the corporation—a claim, moreover, that is secondary to that of any outstanding mortgage bonds. Its claim against net earnings, however, is prior to that of preferred stock.

The short-term note is frequently employed in raising fixed capital.—The designation "short term" is employed because the

[Pages 114-17, which reproduce specimens of stock and bond certificates, are omitted.]

notes in question usually run from one to five years rather than for long periods, as is the case with bonds. These notes are usually secured only by the income of the company. Accordingly it is customary for payments on the principal to be made serially, that is, a certain percentage of the total debt is paid back annually, thus gradually increasing the security back of the loan.

Short-term notes are usually issued to meet temporary emergencies. In periods of tight money and high interest rates, or of general uncertainty over the industrial future, it is difficult to sell long-time bonds on favorable terms; hence it has been found expedient to sell short-term notes which can be refunded into long-term bonds at a more propitious time. Short-term notes are also used—and increasingly so—to provide funds for new construction under conditions such that the debt can be paid off out of earnings within a relatively short period of time. Their claim on income is secondary to that of bonds.

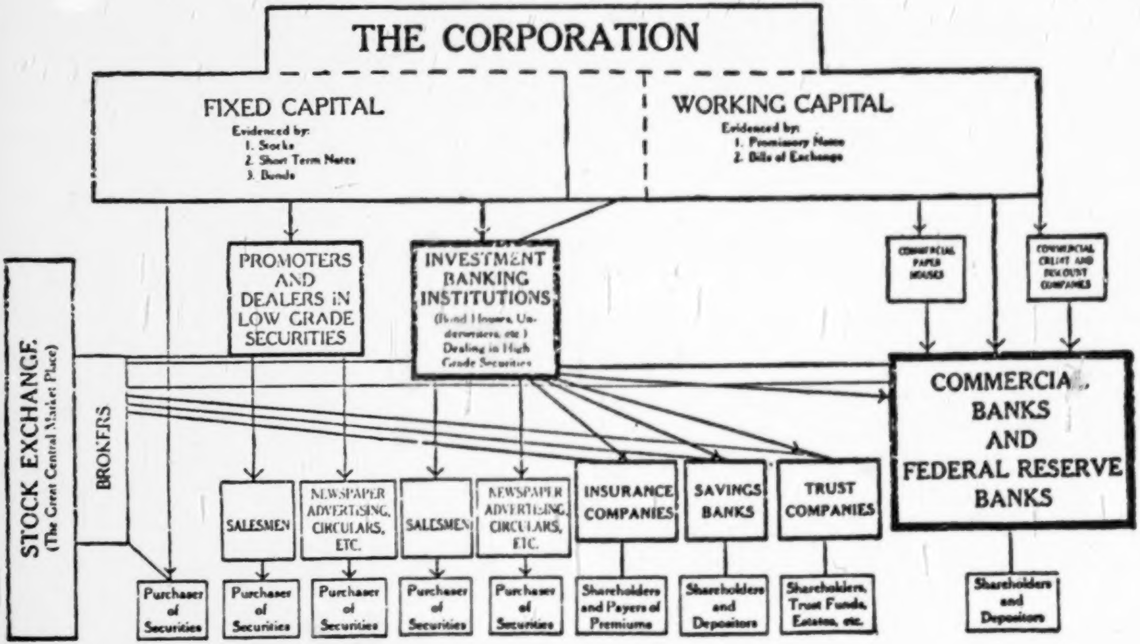
The accompanying illustrations are examples of a standard bond and a share of stock.

II. COMMERCIAL CREDIT INSTRUMENTS

Commercial credit instruments--promissory notes and bills of exchange--are the written evidences of the commercial borrowing operations discussed in the preceding chapter. Because of the nature of the uses to which funds borrowed for working-capital purposes are devoted, these instruments run for short periods of time only. Especial importance is attached to them because of the prevalent use of certain forms of bills of exchange as substitutes for money, a phenomenon made possible, as we shall see, by the principle of negotiability.

Book accounts.—Many credit operations are evidenced merely by entries in the account books of business men—"accounts receivable" in the books of the seller (or lender), and "accounts payable" in the books of the buyer (or borrower). While such informal credit extension is quite as significant as

II. INSTITUTIONS UTILIZED IN FINANCING CORPORATE ENTERPRISE



APPENDIX B

$150,000,000

CITICORP

16.45% Notes Due November 1, 1986

Price 100%

plus accrued interest, if any, from November 9, 1981

Upon request, a copy of the Prospectus describing these securities and the business of the Company may be obtained within any State from any Underwriter who may legally distribute it within such State. The securities are offered only by means of the Prospectus, and this announcement is neither an offer to sell nor a solicitation of any offer to buy.

Goldman, Sachs & Co.

The First Boston Corporation

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

Salomon Brothers Inc

Warburg Paribas Becker
A. G. Becker

Morgan Stanley & Co. Incorporated — Bache Halsey Stuart Shields Incorporated — Bear, Stearns & Co. — Blyth Eastman Paine Webber Incorporated

Dillon, Read & Co. Inc. — Donaldson, Lufkin & Jenrette Securities Corporation — Drexel Burnham Lambert Incorporated

E. F. Hutton & Company Inc. — Keefe, Bruyette & Woods, Inc. — Kidder, Peabody & Co. Incorporated — Lazard Frères & Co.

Lehman Brothers Kuhn Loeb Incorporated — L. F. Rothschild, Unterberg, Towbin — Shearson/American Express Inc.

Smith Barney, Harris Upham & Co. Incorporated — Wertheim & Co., Inc. — Dean Witter Reynolds Inc.

Bateman Eichler, Hill Richards Incorporated — William Blair & Company — Blunt Ellis & Loewi Incorporated — J. C. Bradford & Co.

Alex. Brown & Sons — Dain Bosworth Incorporated — A. G. Edwards & Sons, Inc. — Janney Montgomery Scott Inc.

Ladenburg, Thalmann & Co. Inc. — McDonald & Company — Moseley, Hallgarten, Estabrook & Weeden Inc.

New Court Securities Corporation — The Ohio Company — Oppenheimer & Co., Inc.

Piper, Jaffray & Hopwood Incorporated — Prescott, Ball & Turben — Rauscher Pierce Refsnes, Inc.

The Robinson-Humphrey Company, Inc. — Rotan Mosle Inc. — Thomson McKinnon Securities Inc.

Tucker, Anthony & R. L. Day, Inc. — Wheat, First Securities, Inc.

American Securities Corporation — Sanford C. Bernstein & Co., Inc. — Burns Fry and Timmins Inc.

Butcher & Singer Inc. — The Chicago Corporation — Craigie Incorporated — First of Michigan Corporation

Freeman Securities Company, Inc. — Interstate Securities Corporation — Laidlaw Adams & Peck Inc.

Cyrus J. Lawrence Incorporated — Legg Mason Wood Walker Incorporated — Neuberger & Berman — Stone & Youngberg

Burton J. Vincent, Chesley & Co. — Wood Gundy Incorporated

November 2, 1981

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Wall St. J., Nov. 2, 1981, at 41

$100,000,000

CATERPILLAR TRACTOR CO.

14¾% Notes, due November 1, 1988

Price 100%

plus accrued interest from November 1, 1981

Upon request, a copy of the Prospectus describing these securities and the business of the Company may be obtained within any State from any Underwriter who may legally distribute it within such State. The securities are offered only by means of the Prospectus, and this announcement is neither an offer to sell nor a solicitation of any offer to buy.

Goldman, Sachs & Co.

Lehman Brothers Kuhn Loeb
Incorporated

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

The First Boston Corporation
Salomon Brothers Inc

Bache Halsey Stuart Shields Incorporated
Bear, Stearns & Co.
Blyth Eastman Paine Webber Incorporated

Dillon, Read & Co. Inc.
Donaldson, Lufkin & Jenrette Securities Corporation
Drexel Burnham Lambert Incorporated

E. F. Hutton & Company Inc.
Kidder, Peabody & Co. Incorporated
Lazard Frères & Co.

L. F. Rothschild, Unterberg, Towbin
Shearson/American Express Inc.
Smith Barney, Harris Upham & Co. Incorporated

Warburg Paribas Becker A. G. Becker
Wertheim & Co., Inc.
Dean Witter Reynolds Inc.

ABD Securities Corporation
Advest, Inc.
Arnhold and S. Bleichroeder, Inc.

Atlantic Capital Corporation
Basle Securities Corporation
Alex. Brown & Sons

F. Eberstadt & Co., Inc.
A. G. Edwards & Sons, Inc.
EuroPartners Securities Corporation

Robert Fleming Incorporated
Kleinwort, Benson Incorporated
Ladenburg, Thalmann & Co. Inc.

Moseley, Hallgarten, Estabrook & Weeden Inc.
New Court Securities Corporation
Oppenheimer & Co., Inc.

Piper, Jaffray & Hopwood Incorporated
Thomson McKinnon Securities Inc.
Tucker, Anthony & R. L. Day, Inc.

American Securities Corporation
Bacon, Whipple & Co.
Robert W. Baird & Co. Incorporated

Bateman Eichler, Hill Richards Incorporated
Sanford C. Bernstein & Co., Inc.
William Blair & Company

Blunt Ellis & Loewi Incorporated
Boettcher & Company
J. C. Bradford & Co.
Burns Fry and Timmins Inc.

Butcher & Singer Inc.
Dain Bosworth Incorporated
Daiwa Securities America Inc.
Dominion Securities Ames Inc.

Fahnestock & Co.
First of Michigan Corporation
First Southwest Company
Foster & Marshall Inc.

Greenshields & Co Inc
J. J. B. Hilliard, W. L. Lyons, Inc.
Howard, Weil, Labouisse, Friedrichs Incorporated

Interstate Securities Corporation
Investment Corporation of Virginia
Janney Montgomery Scott Inc.

Johnson, Lane, Space, Smith & Co., Inc.
Johnston, Lemon & Co. Incorporated
Josephthal & Co. Incorporated

Legg Mason Wood Walker Incorporated
McDonald & Company
Moore & Schley, Cameron & Co.

Neuberger & Berman
Newhard, Cook & Co. Incorporated
The Nikko Securities Co. International, Inc.

Nomura Securities International, Inc.
The Ohio Company
Parker/Hunter Incorporated
Prescott, Ball & Turben

Rauscher Pierce Refsnes, Inc.
The Robinson-Humphrey Company, Inc.
Rotan Mosle Inc.

Scherck, Stein & Franc, Inc.
Schneider, Bernet & Hickman, Inc.
Stephens Inc.
Stifel, Nicolaus & Company Incorporated

Sutro & Co. Incorporated
Underwood, Neuhaus & Co. Incorporated
Wedbush, Noble, Cooke, Inc.

Wheat, First Securities, Inc.
Wood Gundy Incorporated
Yamaichi International (America), Inc.

Craigie Incorporated
Daniels & Bell, Inc.
Elkins & Co.
Ferris & Company Incorporated

First Harlem Securities Corporation
Furman Selz Mager Dietz & Birney Incorporated
Gruntal & Co.

Herzfeld & Stern
Cyrus J. Lawrence Incorporated

November 9, 1981

Wall St. J, Nov. 9, 1981, at 45

$50,000,000

Borg-Warner Acceptance Corporation

15¼% Notes due November 15, 1988

Price 99.60%

plus accrued interest from November 15, 1981

Upon request, a copy of the Prospectus describing these securities and the business of the Company may be obtained within any State from any Underwriter who may legally distribute it within such State. The securities are offered only by means of the Prospectus, and this announcement is neither an offer to sell nor a solicitation of any offer to buy.

Goldman, Sachs & Co.

The First Boston Corporation
Merrill Lynch White Weld Capital Markets Group (Merrill Lynch, Pierce, Fenner & Smith Incorporated)
Salomon Brothers Inc
Bache Halsey Stuart Shields Incorporated
Bear, Stearns & Co.
Blyth Eastman Paine Webber Incorporated
Dillon, Read & Co. Inc.
Donaldson, Lufkin & Jenrette Securities Corporation
Drexel Burnham Lambert Incorporated
E. F. Hutton & Company Inc.
Kidder, Peabody & Co. Incorporated
Lazard Frères & Co.
Lehman Brothers Kuhn Loeb Incorporated
L. F. Rothschild, Unterberg, Towbin
Shearson/American Express Inc.
Smith Barney, Harris Upham & Co. Incorporated
Warburg Paribas Becker (A. G. Becker)
Wertheim & Co., Inc.
Dean Witter Reynolds Inc.
ABD Securities Corporation
Advest, Inc.
Arnhold and S. Bleichroeder, Inc.
Atlantic Capital Corporation
Bacon, Whipple & Co.
Robert W. Baird & Co. Incorporated
Basle Securities Corporation
Bateman Eichler, Hill Richards Incorporated
William Blair & Company
Blunt Ellis & Loewi Incorporated
Boettcher & Company
J. C. Bradford & Co.
Alex. Brown & Sons
Dain Bosworth Incorporated
A. G. Edwards & Sons, Inc.
EuroPartners Securities Corporation
First Southwest Company
Robert Fleming Incorporated
Foster & Marshall Inc.
Janney Montgomery Scott Inc.
Kleinwort, Benson Incorporated
Ladenburg, Thalmann & Co. Inc.
McDonald & Company
Moseley, Hallgarten, Estabrook & Weeden Inc.
New Court Securities Corporation
The Ohio Company
Oppenheimer & Co., Inc.
Piper, Jaffray & Hopwood Incorporated
Prescott, Ball & Turben
Rauscher Pierce Refsnes, Inc.
The Robinson-Humphrey Company, Inc.
Rotan Mosle Inc.
Sutro & Co. Incorporated
Thomson McKinnon Securities Inc.
Tucker, Anthony & R. L. Day, Inc.
Wheat, First Securities, Inc.
Sanford C. Bernstein & Co., Inc.
Burns Fry and Timmins Inc.
Dominion Securities Ames Inc.
Greenshields & Co Inc
Neuberger & Berman
Wood Gundy Incorporated
Craigie Incorporated

November 12, 1981

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Wall St. J, Nov. 12, 1981, at 40

This announcement is under no circumstances to be construed as an offer to sell or as a solicitation of an offer to buy any of these securities.
The offering is made only by the Prospectus.

NEW ISSUE

November 23, 1981

$75,000,000

Credithrift Financial Corporation

15½% Senior Notes due December 1, 1991

Price 100%

(Plus accrued interest from December 1, 1981)

Copies of the Prospectus may be obtained in any State in which this announcement is circulated from only such of the undersigned or other dealers or brokers as may lawfully offer these securities in such State.

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

The First Boston Corporation	Goldman, Sachs & Co.	Salomon Brothers Inc	Bache Halsey Stuart Shields Incorporated
Bear, Stearns & Co.	Blyth Eastman Paine Webber Incorporated	Dillon, Read & Co. Inc.	Drexel Burnham Lambert Incorporated
E. F. Hutton & Company Inc.	Kidder, Peabody & Co. Incorporated		Lazard Frères & Co.
L. F. Rothschild, Unterberg, Towbin	Shearson/American Express Inc.		Smith Barney, Harris Upham & Co. Incorporated
Warburg Paribas Becker A. G. Becker	Wertheim & Co., Inc.		Dean Witter Reynolds Inc.
Alex. Brown & Sons	A. G. Edwards & Sons, Inc.	Thomson McKinnon Securities Inc.	Robert W. Baird & Co. Incorporated
William Blair & Company	Blunt Ellis & Loewi Incorporated	J. C. Bradford & Co.	Butcher & Singer Inc.
Dain Bosworth Incorporated			
Foster & Marshall Inc.	Janney Montgomery Scott Inc.	Kleinwort, Benson Incorporated	McDonald & Company
Moseley, Hallgarten, Estabrook & Weeden Inc.	Nomura Securities International, Inc.		Piper, Jaffray & Hopwood Incorporated
Prescott, Ball & Turben	Rotan Mosle Inc.		Wheat, First Securities, Inc.
American Securities Corporation	Freeman Securities Company, Inc.	Herzfeld & Stern	Laidlaw Adams & Peck Inc.

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Wall St. J., Nov. 23, 1981, at 39

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Securities.
The offer is made only by the Prospectus.

$400,000,000

E. I. du Pont de Nemours and Company

14% Notes Due 1991

Interest payable June 1 and December 1

Price 100% and Accrued Interest

Copies of the Prospectus may be obtained in any State from only such of the undersigned as may legally offer these Securities in compliance with the securities laws of such State.

MORGAN STANLEY & CO. THE FIRST BOSTON CORPORATION

GOLDMAN, SACHS & CO. MERRILL LYNCH WHITE WELD CAPITAL MARKETS GROUP SALOMON BROTHERS INC

BACHE HALSEY STUART SHIELDS BEAR, STEARNS & CO. BLYTH EASTMAN PAINE WEBBER

DILLON, READ & CO. INC. DONALDSON, LUFKIN & JENRETTE DREXEL BURNHAM LAMBERT

E. F. HUTTON & COMPANY INC. KIDDER, PEABODY & CO. LAZARD FRERES & CO.

LEHMAN BROTHERS KUHN LOEB L. F. ROTHSCHILD, UNTERBERG, TOWBIN

SHEARSON/AMERICAN EXPRESS INC. SMITH BARNEY, HARRIS UPHAM & CO.

WARBURG PARIBAS BECKER WERTHEIM & CO., INC. DEAN WITTER REYNOLDS INC.

ATLANTIC CAPITAL BASLE SECURITIES CORPORATION ALEX. BROWN & SONS

MOSELEY, HALLGARTEN, ESTABROOK & WEEDEN INC. OPPENHEIMER & CO., INC.

THOMSON McKINNON SECURITIES INC. TUCKER, ANTHONY & R. L. DAY, INC. ADVEST, INC.

ARNHOLD AND S. BLEICHROEDER, INC. SANFORD C. BERNSTEIN & CO., INC.

BURNS FRY AND TIMMINS INC. DAIWA SECURITIES AMERICA INC. DOMINION SECURITIES AMES INC.

ROBERT FLEMING JANNEY MONTGOMERY SCOTT INC. LADENBURG, THALMANN & CO. INC.

THE NIKKO SECURITIES CO. NOMURA SECURITIES INTERNATIONAL, INC.

WOOD GUNDY INCORPORATED YAMAICHI INTERNATIONAL (AMERICA), INC.

November 23, 1981

Wall St. J., Nov. 23, 1981, at 42